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No. 409

In the Supreme Court of the United States

OCTOBER TERM, 1961

ESTATE OF WILLIAM P. COOPER, etc., et al.,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

COOPER AGENCY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 469

ESTATE OF WILLIAM P. COOPER, etc., et al.,
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v.

COMMISSIONER OF INTERNAL REVENUE

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court's memorandum findings of fact and opinion in the case of *Estate of Cooper* v. *Commis-*

sioner (R. 206-226) are not officially reported. Its findings of fact and opinion in the case of *Perpetual Building and Loan Association of Columbia* v. *Commissioner* (R. 155-189) are reported at 34 T.C. 694. Its findings of fact and opinion in the case of *Cooper Agency* v. *Commissioner* (R. 190-205) are reported at 33 T.C. 709. The *per curiam* opinion of the Court of Appeals (Pet. 16-18) is reported at 291 F. 2d 831.

JURISDICTION

The judgments of the Court of Appeals (Pet. 18-20) were entered on June 19, 1961. The petition for a writ of certiorari was filed on September 15, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether both courts below correctly held that the Estate of William Cooper was liable in 1949 for income taxes on dividends declared by Perpetual Building and Loan Association of Columbia during the decedent's lifetime on certain installment share accounts held by the decedent, where the dividends were not paid until after his death.

2. Whether both courts below correctly held that the Commissioner's determination in 1956 of deficiencies in income tax against Perpetual for the years 1945 through 1951 was timely made and was not barred by the statute of limitations, since proper income tax returns had not been filed by Perpetual.

3. Whether both courts below were correct in disallowing a deduction of interest on a total sum of $600,000 claimed by the Cooper Agency to have been borrowed from Perpetual, where the transaction lacked economic reality and a much smaller sum was actually borrowed and used, on which an interest deduction was allowed.

STATUTES INVOLVED

Sections 23(b), 54(f), 101(4), 126(a), 161(a), 275(a) and 276(a) of the Internal Revenue Code of 1939, and Section 302(b) of the Revenue Act of 1950, c. 994, 64 Stat. 906, are set forth in the Appendix, *infra*, pp. 13-16.

STATEMENT

These cases involve the tax consequences of transactions entered into by several organizations, all of which were owned, controlled, managed and dominated by members of the Cooper family. The relevant facts, which were found by the Tax Court (R. 158-175, 191-197, 207-217) and agreed to by the Court of Appeals (Pet. 17-18), may be summarized very briefly as follows:

1. Estate of Cooper

William P. Cooper, the father of Charles, Frank, James and Edwin Cooper, died on December 28, 1948. His wife was executrix under his will.

From 1944 through 1948, William P. Cooper, and three of his sons, James, Frank and Charles, as well

as Charles' wife, Virginia, held installment share accounts with Perpetual (which was controlled and operated by Charles, Frank and James Cooper).

In 1944 William Cooper paid $2,273.26 into his installment share account. Between June 30, 1946, and December 31, 1947, Perpetual declared so-called stock dividends to its installment share accounts. As a result, William's share was credited with $115,172.39 of dividends, and as of the date of his death, December 28, 1948, the appraised value of his account was $117,445.65.[1]

During the period here involved the current dividend paid by Perpetual on other types of share accounts was 4 per cent per annum.

On February 17, 1949, Perpetual repurchased the shares in full from William Cooper's estate for $117,445.65. The payment was paid in escrow to another savings and loan association controlled by the Coopers.

Both courts below held (R. 218-226, Pet. 17-18) that the $115,172.39 of dividend credits constituted ordinary dividends on Perpetual's earnings, and that this amount was taxable as ordinary income to the estate in 1949, the year in which the account was surrendered and the proceeds withdrawn from Perpetual.

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[1] Likewise, Virginia Cooper, having a credit balance in her installment share account of $1,800, received dividend credits of $24,000. Charles Cooper received $50,000 of dividend credits to his account for which he had initially paid in $10,000. Frank Cooper received $45,000 of dividend credits to his account, for which he initially had paid in $9,000; and James Cooper, who had initially paid $9,100 into his account, received $50,000 of dividend credits.

2. Perpetual

Perpetual was chartered as a building and loan association under the laws of South Carolina. It was controlled and operated by Charles, Frank and James Cooper. In 1946, the Commissioner advised Perpetual, based upon information furnished by Charles Cooper, that Perpetual was entitled to an exemption from federal income taxes under Section 101(4) of the Internal Revenue Code of 1939.

For each of the years 1945 through 1951, Perpetual filed an information return, Form 990, with the Collector of Internal Revenue, but did not file any corporation income tax returns for any of these years.

Subsequently, the Commissioner determined that Perpetual had not been operated in accordance with Section 101(4) either when it requested an exemption or afterwards. Accordingly, on November 12, 1952, the Commissioner retroactively revoked his prior ruling and determined that Perpetual was not exempt from taxation for the years beginning with 1944. Perpetual was informed that it was required to file federal income tax returns on Form 1020 beginning with the year 1944, which it failed to do.

Both courts below held (R. 175-184, Pet. 17-18) that Perpetual was not entitled to an exemption from income and excess profits taxes under Section 101(4) for the years 1945 through 1951, on the grounds that it lacked the essential characteristics of a legitimate building and loan association and that it had been used by the Cooper brothers as a means of avoiding taxation on profits derived from real estate transactions carried on through Perpetual for their benefit.

Both courts below also held (R. 184-187, Pet. 17-18) that the Commissioner's determination of deficiencies was not barred by the statute of limitations since proper income tax returns had not been filed by Perpetual for the years 1944 through 1951.

3. Cooper Agency

The four Cooper brothers, Charles, Frank, Edwin and James, owned all of the stock of Cooper Agency in equal amounts and were its sole officers. Three of the Cooper brothers, Charles, Frank and James, purchased a tract of property with money borrowed from Perpetual which they resold to Cooper Agency. Cooper Agency constructed and sold 198 small dwellings on part of this property.

Frank Cooper, on behalf of Cooper Agency, and Charles Cooper, on behalf of Perpetual, orally agreed that Perpetual would loan $600,000 to Cooper Agency to construct the 198 houses. (R. 192, 193.) Perpetual entered $600,000 on its books as "Loans in Process" to Cooper Agency on March 25, 1950. On that date, the first advance of funds to Cooper Agency was made in the amount of $5,000. Thereafter, other cash advances were made periodically. Cooper Agency sold the houses promptly after completion. As houses were sold, the proceeds of sale were paid over to Perpetual. Perpetual charged interest at the rate of 7 per cent per annum on the entire loan of $600,000 from the time of the inception of the arrangement. At no time did Cooper Agency have an outstanding net balance of more than $165,000 owing to Perpetual and during most of the time the net balance owed was much less than $165,000.

On its federal tax returns for 1950 and 1951, Cooper Agency deducted $15,458.42 and $22,794.88, respectively, as interest payments calculated at 7 per cent on $600,000. The Commissioner allowed interest deductions only on the basis of the outstanding balance of funds advanced to Cooper Agency. Both courts below held (R. 198-203, Pet. 17-18) that the so-called $600,000 loan lacked economic reality, that a much smaller sum was actually borrowed and used, and that interest deductions of only $2,369.85 in 1950, and $3,564.79 in 1951, calculated at 7 per cent on the outstanding net balances owed, properly were allowable.

ARGUMENT

The decision below is correct. The questions involved are primarily factual; there is no conflict and no occasion for further review by this Court.

1. Section 126(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 14) provides that all items of gross income in respect of a decedent which are not properly includible in income of the taxable year in which the decedent died or of a prior year shall be included in the gross income of the estate for the taxable year in which the estate received it, if the right to such income is acquired by the estate from the decedent. Thus the amount includible in income by the estate is treated for tax purposes the same as it would have been treated had the decedent lived and received the money himself. *O'Daniel's Estate* v. *Commissioner*, 173 F. 2d 966 (C.A. 2d); *United States* v. *Ellis*, 264 F. 2d 325 (C.A. 2d).

Both courts below properly applied the applicable law to determine that the dividend income first became taxable to the estate of William Cooper in 1949. Perpetual's by-laws prohibited the cash payment of dividends to an installment account until the account matured or was surrendered to Perpetual in its entirety. (R. 209-211.) Not until 1949 did the executrix surrender the entire share account and Perpetual repurchase the shares in full from her for $117,445.65, of which $115,172.39 represented dividend credits. Before these events took place neither William nor the estate had any unqualified right to the cash represented by the dividends. Hence, there was no constructive receipt of the dividend income by William during the years 1945 through 1948. See Treasury Regulations 111, Section 29.42-3, promulgated under the Internal Revenue Code of 1939.

There is no merit to the Estate's contention that both courts below erred in failing to hold that William accrued income in the years 1945 through 1948 when the dividends were credited by Perpetual to his installment account. True, dividends may become taxable to a shareholder in the year of credit under certain circumstances. But here there was no showing by the Estate that the dividend credits were unqualifiedly subject to the demand of William or of his estate prior to 1949.[2]

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[2] *Ross* v. *Commissioner*, 169 F. 2d 483 (C.A. 1st), relied upon by the Estate (Pet. 7), is not in conflict with the decisions below. In *Ross* there was a finding that the salaries credited to an officer on the books of a corporation were unqualifiedly subject to his demand in the year in which the credits were made.

2. Section 275(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 15) limits the assessment and collection of taxes within three years after the return is filed. However, Section 276(a) (Appendix, *infra*, p. 15) permits an assessment to be made at any time where no return is filed. Perpetual does not question the findings below that it did not file any corporate income or excess profits tax returns for the years 1945 through 1951.[3] Nor do information returns filed under Section 54(f) of the 1939 Code (Appendix, *infra*, p. 13) qualify as tax returns for Section 275(a) purposes. *Automobile Club* v. *Commissioner*, 353 U.S. 180, 188, rehearing denied, 353 U.S. 989; *Francis Edward McGillick Foundation* v. *Commissioner*, 278 F. 2d 643, 648-649 (C.A. 3d).

Furthermore, Perpetual is not entitled to any relief under Section 302(b) of the Revenue Act of 1950 (Appendix, *infra*, p. 16), which permits the filing of an information return, in certain limited circumstances, to be regarded as equivalent to the filing of a tax return for the purpose of the statute of limitations. Section 302(b) is inapplicable here since it applies only to organizations referred to in Section 302(a)—certain charitable and similar organizations exempt under paragraphs (1), (6) or (7) of Section 101—and then only if the exemption was denied on

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[3] Perpetual is not contesting the holding below (R. 175-184, Pet. 17-18), that it was not entitled to an exemption from tax under Section 101(1) of the 1939 Code (Appendix, *infra*, p. 11), and that the Commissioner may retroactively revoke an exemption previously granted.

the ground that such an organization was carrying on an unrelated business activity for profit. See S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 26-39, 117-119 (1950-2 Cum. Bull. 483, 502-512, 567-568); H. Conference Rep. No. 3124, 81st Cong., 2d Sess., p. 35 (1950-2 Cum. Bull. 580, 590). Here, Perpetual had not been granted an exemption under paragraphs (1), (6) or (7) of Section 101, and its right to an exemption had not been revoked because it had earned unrelated business income. Instead, the Commissioner's revocation was predicated upon the fact that Perpetual had not been operated in accordance with the standards set forth in Section 101(4) (Appendix, *infra*, p. 14), *i.e.*, that it had not been operated as a true building and loan association and that substantially all its business had not been confined to making loans to members.[4]

3. Section 23(b) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 13) permits a deduction for interest paid or accrued within a taxable year.

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[4] The Tax Court correctly noted (R. 186-187) that Section 6501(g) of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sec. 6501(g))—providing that, if a taxpayer determines in good faith that it is an exempt organization and files an information return, that return will be considered equivalent to the tax return of the organization for the purposes of the running of the period of limitations—is inapplicable here. This provision has no counterpart in prior law and does not apply retroactively.

Cooper Agency, insisting that it was obligated to pay Perpetual interest on $600,000, contends that the courts below erred in disallowing part of the interest deductions claimed by it in its 1950 and 1951 returns. But both courts below concluded, on the basis of adequately supported findings (R. 192-195, 198-203; Pet. 17-18), that the asserted $600,000 loan—more than actually required by Cooper Agency to finance its construction and more than actually advanced by Perpetual to Cooper Agency—was in effect nothing more than a device to permit the Cooper brothers to take a larger deduction for their taxable corporation, Cooper Agency, in the guise of interest paid, and to allocate more of the income from the sale of the 198 houses to their exempt corporation in the guise of interest. This Court will not review concurrent findings of fact in the absence of exceptional error. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214; *Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 51. While Perpetual set up a so-called loan account on its books, the facts are that amounts totaling less than $600,000 were doled out to Cooper Agency as construction advanced, that Cooper Agency periodically repaid the advances as it sold houses, that Cooper Agency never owed Perpetual more than $165,000 at any one time, and that for most of the time the net outstanding balance was much smaller. Nor was there any evidence that Perpetual agreed to set aside $600,000 for the use of Cooper Agency, or that such an amount was unqualifiedly subject to the demands of Cooper Agency. (R. 64-66, 116-118, 135-136, 138, 148-150.) In the circumstances, the

disallowance of the asserted interest deduction was justified. See *Knetsch* v. *United States*, 364 U.S. 361; *1432 Broadway Corp.* v. *Commissioner*, 160 F. 2d 885 (C.A. 2d), affirming *per curiam* 4 T.C. 1158, 1164-1165; *Weller* v. *Commissioner*, 270 F. 2d 294 (C.A. 3d); see also *Gregory* v. *Helvering*, 293 U.S. 465, 469-470; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334.[5]

CONCLUSION

The decisions below are correct; there is no conflict; the issues are primarily factual and limited to the facts of these cases and are not of general importance. Accordingly, the petition for certiorari should be denied.

Respectfully submitted,

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NOVEMBER, 1961.

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[5] There is no conflict between the decision below and the cases, relied upon by the taxpayers (Pet. 10), in which the courts found that the respective indebtedness there involved reflected bona fide transactions in the amounts claimed.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

* * * *

SEC. 54. RECORDS AND SPECIAL RETURNS.

* * * *

(f) [As added by Sec. 117(a), Revenue Act of 1943, c. 63, 58 Stat. 21] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the

approval of the Secretary, may from time to time prescribe. * * *

* * * *

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS [53 Stat. 33].

The following organizations shall be exempt from taxation under this chapter—

* * * *

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

* * * *

SEC. 126 [As added by Sec. 134(e), Revenue Act of 1942, c. 619, 56 Stat. 798]. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right

to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * *

SEC. 161. IMPOSITION OF TAX [53 Stat. 66].

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * *

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * *

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * *

Revenue Act of 1950, c. 994, 64 Stat. 906:

SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS.

* * * *

(b) *Period of Limitations.*—In the case of an organization which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit, the filing of the information return required by section 54(f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). In the case of such an organization which was, by the provisions of section 54(f) of the Internal Revenue Code, specifically not required to file such information return, for the purposes of the preceding sentence a return shall be deemed to have been filed at the time when such return should have been filed had it been so required. The provisions of this subsection shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950, (1) any amount of tax was assessed or paid, or (2) a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer.

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